

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair  
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In the Matter of the Commission's  
Investigation into the Appropriateness of  
Continuing to Permit Electric Energy Cost  
Adjustments

ISSUE DATE: December 19, 2003

DOCKET NO. E-999/CI-03-802

ORDER DETERMINING SCOPE AND  
SETTING PROCEDURAL FRAMEWORK

**PROCEDURAL HISTORY**

On June 4, 2003, the Commission issued its ORDER APPROVING PROPOSAL, REQUIRING COMPLIANCE FILING, AND OPENING INVESTIGATION INTO THE CONTINUING USEFULNESS OF FUEL CLAUSE ADJUSTMENTS FOR ELECTRIC UTILITIES, initiating this docket.

On June 12, 2003, the Commission solicited comments on the investigation's scope and appropriate procedural framework.

By July 21, 2003, the Commission had received comments from the Minnesota Department of Commerce (the Department), Minnesota Power Company (Minnesota Power), Northern States Power Company d/b/a Xcel Energy (Xcel), Otter Tail Power Company (Otter Tail) and Myer Shark.

By August 1, 2003, the Commission had received reply comments from the Department, Minnesota Power, Mr. Shark and Xcel.

On November 6, 2003, the matter came before the Commission.

**FINDINGS AND CONCLUSIONS**

**I. Introduction**

As the Commission noted in its prior order, the fuel clause adjustment (FCA) is a mechanism that permits electric utilities to automatically adjust their rates to pass through changes in the cost of fuel or purchased power.

FCAs reflect, on a per kilowatt-hour basis, deviations from the base cost of energy established in the utility's most recent general rate case. Rates include an energy cost component calculated in the general rate case by determining system-wide costs for fuel and purchased power and then allocating these costs among customer classes. The allocation formula is necessarily complex, and takes into account the total and proportionate numbers of customers per class, total and proportionate class usage levels, and total and proportionate on-peak and off-peak class usage levels.

Minnesota Statutes § 216B.16, subdivision 7, authorizes the Commission to permit electric utilities to use FCAs, and all Minnesota's rate-regulated electric utilities currently use them. The utilities file monthly adjustments to their rates that take effect without prior Commission review; they then file detailed monthly and annual reports, which are reviewed for accuracy and prudence. These automatic rate adjustments are intended to make rates more accurate and to conserve regulatory and utility resources. Since fuel and purchased power costs can fluctuate significantly between rate cases, building these costs into non-adjustable rates could cause significant, recurring mismatches between expenses and rates. It might also strain utility and regulatory resources by forcing frequent rate cases and earnings investigations to address changes in the cost of fuel and purchased power.

While the advantages of FCAs are understood, their disadvantages have not been carefully examined since their initial adoption. Furthermore, since that time the kinds of costs recovered through the fuel clause have significantly changed. Purchased power costs and the costs associated with the practice of "hedging," for example, are very different from the straightforward fuel costs the fuel clause was originally designed to recover. As the Department notes, these new costs may pose different issues in terms of risk management, price signals, oversight and accountability. Consequently, the Commission has elected to investigate this matter.

## **II. Position of the Parties**

While the parties offer many substantive comments, this Order will address only the investigation's scope and procedural framework.

### **A. What topics should the investigation address?**

The parties identify various topics for analysis.

*Purposes.* The Department and Xcel recommend reviewing the FCA's purposes, identifying the ratemaking challenges the FCA was intended to address.

*Types of cost passed through.* The Department and Xcel propose cataloging the types of costs passed through to customers via the FCA, such as the cost of fuel used in generation and federally-regulated wholesale power purchases. In addition, the Department and Minnesota Power

encourage the Commission to investigate the extent to which costs incurred by the Midwest Independent System Operator (MISO)<sup>1</sup> may be recovered through its members' FCAs.

*Miscellaneous adjustments.* Xcel proposes analyzing whether pass-throughs such as Conservation Improvement Factor (CIP) or the Renewable Development Fund (RDF) should be better separated from the FCA, and whether they impede the Commission's ability to ensure reasonable rates. In the interest of focusing the investigation, the Department and Minnesota Power recommend omitting discussions of such miscellaneous adjustments.

*Mandates.* Xcel proposes studying how the FCA is used in implementing various mandates, such as passing through federally-approved wholesale costs.

*Risk management.* The Department, Minnesota Power and Xcel propose exploring the use of the FCA to implement mechanisms to "hedge" the cost of purchased power and fuel.

*Utility incentives.* The Department, Minnesota Power and Mr. Shark recommend investigating the FCA's affect on a utility's incentive to minimize costs. However, Otter Tail argues that it has adequate incentive to minimize costs regardless of the FCA.

*Price signals.* The Department, Minnesota Power and Xcel propose investigating whether the FCA helps inform consumers about the cost of electricity. Otter Tail disputes the suggestion that the FCA impairs price signals. Furthermore, Mr. Shark doubts that customers actually change their behavior in response to such price signals, and proposes an investigation of that matter.

*Alternatives.* The Department and Xcel propose evaluating alternatives to the current FCA mechanism, including Xcel's use of a projected FCA.

*The relationship between buyers and sellers.* Mr. Shark recommends reviewing the subject of affiliate transactions. In particular, he asks the Commission to determine the amount of fuel and power that Xcel bought from its affiliated power marketer NRG in 2001 and 2002. The Department opposes this suggestion, arguing that these matters would be addressed more appropriately in the context of automatic cost adjustment filings.

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<sup>1</sup> A collection of Midwestern electric utilities formed MISO to coordinate the operation of the regional transmission grid. See In the Matter of the Petition for Approval to Transfer Functional Control of Certain Transmission Facilities to the Midwest Independent System Operator, Docket No. E-002/M-00-257; In the Matter of Minnesota Power's Petition for Approval of Transfer of Operational Control of Transmission Facilities, Docket No. E-015/PA-01-539; In the Matter of Otter Tail Power Company's Petition for Approval of Transfer of Operational Control of Transmission Facilities to the Midwest Independent System Operator, Docket No. E-017/PA-01-1391; In the Matter of Interstate Power Company's Petition for Approval of Transfer of Operational Control of Transmission Facilities to the Midwest Independent System Operator, Docket No. E-001/PA-01-1505.

*Fuel cost ratio.* Mr. Shark proposes investigating the percentage of electricity costs attributable to fuel, and how this percentage has changed over time. The Department favors this proposal.

*Share of household income.* Mr. Shark proposes investigating the percentage of household income consumed by electricity costs, and how this percentage has changed over time. The Department questions the relevance of this proposal to the current docket.

*Mechanics of the fuel clause.* Mr. Shark proposes that the Commission determine whether FCA changes are triggered by changes in the cost of fuel that has already been consumed, or that will be consumed. He proposes investigating the amount and timing of adjustments, determining whether the adjustments reflect then-current market prices for fuel and power, or merely a utility's contract price for fuel and power. Finally, Mr. Shark proposes investigating how each utility's FCA differs from the others. The Department supports investigating the formulas used to determine the amount and timing of FCAs.

*No further topics.* Otter Tail recommends that the investigation not address any additional topics. To the contrary, Otter Tail recommends that the Commission review the current filings, conclude that the record does not support changes to the FCA, and close the docket. The Department opposes this suggestion, arguing that the record is not yet adequate to permit an evaluation of FCAs.

## **B. Which parties should participate in the investigation?**

The docket currently encompasses all electric utilities within the Commission's jurisdiction. As an initial matter, the Department favors including all such utilities. The Department would not discourage a utility from seeking to be excused based on individual circumstances. But the Department argues that the docket must include at a minimum Minnesota's MISO members to address the extent to which MISO costs may be recovered through a FCA. Xcel supports including Minnesota's MISO members within the investigation.

Mr. Shark recommends soliciting participation from gas utilities as well, noting the growing importance of natural gas as a fuel for generating electricity. The Department opposes this idea. Given the differences between the structure of the electric and gas industries, analyzing both simultaneously would greatly expand the docket's complexity. In addition, the Department notes that the Commission has already addressed the topic of adjustments for gas procurement.<sup>2</sup>

Mr. Shark also recommends that ratepayers have the opportunity to participate in the investigation.

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<sup>2</sup> See In the Matter of an Investigation into Whether the Purchased Gas Adjustment (PGA) is Still Appropriate, Docket G-999/CI-95-696.

Otter Tail asks to be excused from the docket. Otter Tail notes that many of the concerns that prompted this investigation pertain to Xcel, not Otter Tail. Otter Tail argues that it has adequate incentive to keep its costs low in spite of the FCA, and that eliminating the FCA would cause financial hardship and create administrative burdens for Otter Tail. The Department opposes Otter Tail's request.

### **C. What steps should the investigation take?**

Minnesota Power suggests that the Commission identify the relevant topics to be addressed, and that the parties be given three rounds of comments and replies. If it wished, the Commission could convene a technical conference to hear presentations on any specific topic. The Commission would eventually convene a hearing and make individualized judgments about the propriety of each company's FCA mechanism individually.

Similarly, the Department recommends multiple rounds of comments, each round addressing a specific topic.

Xcel recommends that the Commission identify the specific issues to be addressed and then direct its staff to convene workgroups to develop a recommendation. The Commission would give additional direction following receipt of the workgroup's report.

While Mr. Shark initially suggested that this matter could begin with collaborative fact-finding, he ultimately argues for a contested case proceeding, and even for rate cases, as a means of developing a contemporary record.

As noted above, Otter Tail recommends that the Commission review the current filings, conclude that the FCA does not warrant any changes and close the docket.

### **III. Commission Action**

The Commission appreciates the contributions of the commentors and finds their remarks helpful in designing the future scope of the investigation. The Commission will decline Otter Tail's request to close the investigation at this time. As the Department correctly observes, it would be premature for the Commission to evaluate the FCA when the record of this investigation is not yet fully developed.

While many potential topics have been proposed, as an initial matter the Commission will focus the investigation on the central question of whether the FCA continues to be an appropriate regulatory tool today. To begin, the Commission will direct the parties to review the original purpose, structure, and rationale of the current FCA, current operation of the FCA, and its relevance to the current regulatory environment. Other topics may be added in the future, but it would be premature to expand the investigation until a continuing need for the FCA has been demonstrated. The Commission will authorize its Executive Secretary to develop more specific questions for the parties to address.

On the question of which parties should participate in the investigation, the Department notes that the docket currently extends to all electric utilities within the Commission's jurisdiction, and that all these utilities use an FCA process. The Commission finds the investigation's current scope appropriate. It makes sense to include all these utilities within the investigation because they have information and perspectives to contribute to the analysis and may be bound by any decisions arising from the docket. Consequently, the Commission will accept the recommendation of the Department and decline Otter Tail's request to be excused. The docket will involve Dakota Electric Association, Minnesota Power, Northwestern Wisconsin Electric Company, Interstate Power and Light, Otter Tail and Xcel.

The Commission will decline the suggestion to expand the investigation to encompass natural gas companies. As the Department observed, adding gas utilities would greatly expand the complexity of an already complex investigation, and the Commission has previously addressed the continuing usefulness of the purchased gas adjustment.

Finally, Mr. Shark recommends expanded ratepayer participation in the investigation. The Commission notes that the public interest is ably represented in this matter by the Department. That said, this docket is a matter of public record and nothing precludes ratepayer participation, as demonstrated by Mr. Shark's own participation.

On the subject of the investigation's procedural framework, the majority of commentators favor a combination of written comments and workgroup meetings. The Commission finds it reasonable to develop the record through a process of written comments and replies, although workgroups may also be convened where necessary. The Commission will authorize the Executive Secretary to set schedules and develop questions to assist this process. The Commission will decline Mr. Shark's recommendation to structure this investigation as a contested case proceeding at this early stage, or to initiate rate cases for all the relevant utilities. Such procedures would tend to burden rather than facilitate an analysis of the FCA.

The Commission will so order.

### **ORDER**

1. Initially the investigation shall focus on whether the fuel clause adjustment (FCA) continues to be an appropriate tool for use in the current regulatory environment. The investigation shall begin with a review of the original purpose, structure, and rationale of the current FCA, current operation of the FCA, and relevance to the current regulatory environment. If the Commission finds that the investigation demonstrates a continuing need for the FCA, the Commission may expand the investigation's scope to address related issues. The Executive Secretary is authorized to develop questions for analysis.
2. The investigation will include Dakota Electric Association, Minnesota Power, Northwestern Wisconsin Electric Company, Interstate Power and Light, Otter Tail and Xcel.

3. The investigation shall proceed as follows: Utilities shall file written analyses of the topic articulated in Ordering Paragraph 1 pursuant to the Executive Secretary's Notice attached to this Order. Parties may file comments on the analyses and then file replies to the comments. Where necessary, the Executive Secretary may convene workgroups before bringing a topic to the Commission. The Executive Secretary is authorized to set and change the procedural schedule in this matter.
4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary

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